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OFFICE OF REPORTS AND ESTIMATES
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WORKING PAPER

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INTELLIGENCE HIGHLIGHTS NO. 51
11 May - 17 May 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The US proposal to halt further Japanese reparation payments is expected to meet strong opposition from other FEC member-nations (p. 2).

Despite British strengthening of Hong Kong's defenses, no Chinese Communist attempts to seize the Colony are foreseen in the near future (p. 3).

The problem of gaining Korean endorsement of the intended US troop withdrawal has been increased by the recent defection of a Coast Guard vessel (p. 3). Meanwhile, President Rhee has postponed action on Korean land reform by returning the bill to the National Assembly (p. 4).

In China, the Communist military advance not only continues but appears to have accelerated and the possibility of a direct thrust down to Canton now exists (p. 4). In the face of this threat, the refugee Nationalists there are debating where next to move the remnants of their government (p. 5).

Commonwealth aid to the Burmese Government may well be used for the suppression of the insurgent Karens, rather than for restoration of order through negotiation (p. 7).

Slow but definite progress in committee talks at Batavia indicates that a solution to the Indonesian problem is still a possibility (p. 8).

The marginal notations used in succeeding sections of this Weekly ("A", "B", or "C") indicate the importance of the items in B/FE opinion with "A" representing the most important.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

US halts Japanese reparations---The Far Eastern Commission, last week, heard a US proposal to halt further Japanese machinery and equipment removals for reparations and to lift all restrictions on the levels of Japanese industry. Simultaneously, SCAP received an order to halt all remaining shipments planned under the "advance transfer" program, from which China, Great Britain, the Netherlands and the Philippines have received approximately 52,000 tons of former arsenal equipment. "A"

In justifying the proposal, the US pointed out that reparations have been predicated on the assumption that facilities to be removed as reparations would be surplus to Japan's peaceful needs. Since Japan is facing a tremendous task in attempting to achieve a self-supporting economy, it is the US view that further reparations would make this task even more difficult, if not impossible. It was further pointed out that the US is spending \$500 million annually for relief and rehabilitation in addition to occupation costs, and that foreign aid programs would be jeopardized if the burden of Japan continues to fall upon the US.

This latest US move is the culmination of a series of decisions gradually liberalizing the US reparations policy. In 1946, the Pauley Commission (concerned more with reducing Japan's war potential than with economic rehabilitation) recommended removals valued prewar at \$740 million. In early 1948, the Overseas Consultants reduced the Pauley recommendation to \$495 million and the Johnston Committee, in May 1948, further reduced it to \$200 million.

FEC's continuous failure to agree on such basic issues as the division of reparations among claimant nations, the position of such external assets as seized plant in Manchuria and allowable levels of industrial recovery, has adversely affected Japan's economic stabilization because industries whose plant was slated for reparations removal have hesitated either to undertake capital improvements or to reconvert for peacetime production. However, since about 70% of the equipment earmarked for reparations is presently in use, the immediate effect upon Japan's production index will be slight until enough raw materials are available to demand the use of the additional equipment. Nevertheless, removal of this deterrent to Japan's recovery should prove to be of immediate psychological value in US efforts to revive the country's lethargic economy.

Vigorous and sustained opposition to the new proposal can be expected from the majority of the FEC members, especially from Australia, China and

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the Philippines. The Philippines' Department of Foreign Affairs has already drafted a note of protest for submission to the FEC, and the Australian Secretary for External Affairs has expressed criticism of the "unilateral action of the US in defiance of the views of the majority of the FEC." In view of the intense feeling on the subject, the US probably will be forced to use its veto power in order to effect the new policy.

Future of Hong Kong--That the Chinese Communist Party will probably reopen the Hong Kong question and demand that the UK return Hong Kong and Kowloon to China can be anticipated, since the CCP does not regard the "unequal treaties", by which the UK acquired possession of Hong Kong and a 99-year lease on the New Territories, as valid and considers the British foothold in Hong Kong an affront to Chinese nationalism. The British, in turn, have made it clear several times since V-J Day that they do not intend to relinquish the Colony. On 5 May, the UK Minister of Defense stated in Commons that substantial reinforcements were being dispatched to Hong Kong.

"B"

It is improbable that the CCP will order an assault on Hong Kong in 1949, since a stable Hong Kong under British control offers the Communists great advantages in foreign trade. These advantages, however, will not outweigh Communist nationalistic sentiment in the long run and the return of Hong Kong to China, either through negotiation or military action, will probably occur within the next few years.

KOREA

Ship defection adds to Rhee's woes--A week after the 5 May defection of Korean Republic troops to the North, one of the Republic's larger Coast Guard vessels sailed into the northern Korean port of Wonsan. The vessel is one of sixteen 260-ton YMS craft turned over to the Korean Government by the US.

"B"

Loss of this ship will further complicate the already knotty problem of gaining President Rhee's assent to early US troop withdrawal. The Coast Guard is the weakest arm of the Korean Security Forces and Rhee feels that additional ships and equipment from the US are a necessary prerequisite to troop withdrawal. Furthermore, considerable pressure, not all officially inspired, is being exerted in Seoul to postpone troop withdrawal until: 1) Korean defensive power is more fully developed; 2) Soviet withdrawal from northern Korea is more certain; and 3) the US concludes an alliance or military pact with Korea offering positive military protection.

In view of the demonstrated disloyalty of elements in the Coast Guard and Army and in the absence of positive US guarantees of Korea's

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security, it will be most difficult for Rhee to convince the Korean people that the Security Forces have developed to the point where it is now possible to establish an early date for the withdrawal of US troops.

Rhee sends land bill back to Assembly--The long-sought-for Land Reform Bill, passed recently by the National Assembly of the Republic of Korea, was returned to that body by the State Council (Rhee's executive cabinet) for further work on suggested amendments. Since the suggestions were minor in nature, a hint as to Rhee's real reason for delaying implementation of the Bill may be seen in his specific recommendation that effective date of the law should not be the date of the Assembly's "passage," but the date of the State Council's "promulgation." Whatever the motive, delay on an issue as important as the Land Reform Bill, while pleasing to Korea's conservatives, will not win friends for Rhee among politically aware farmers. Nor will it weaken the Communists' attack against existing land conditions. "C"

The Land Reform Bill, which provides for the sale to farmers of some 1,800,000 acres presently held by absentee landlords, is expected to reduce farm tenancy from 73% at VJ-Day to an estimated 10%. Payment to the landlords will be made immediately in negotiable bonds equivalent in value to the installment payments (in kind) to be made over a period of years to the Government by the purchasing tenants. Land holdings are restricted to a maximum of $7\frac{1}{2}$ acres per farm family, with certain special crop fields (orchards, mulberry, and vegetable gardens) exempted.

CHINA

Communist advance continues--The current Communist offensive rolled forward on all fronts last week and appeared to be on the verge of a new series of successes; Hankow has been taken, Shanghai is in imminent danger of capture, and there are numerous reports that a thrust deep into south China is developing rapidly. "A"

Despite "fierce" resistance by the Nationalist defenders, Communist forces continue to move artillery, additional supplies and forces into position around Shanghai and have all but isolated the city. Although they are now within artillery range of the vital Whangpoo River, sole remaining sea-outlet from the city, they have not yet begun to shell river shipping. Food and fuel stocks within the city, adequate until mid-June, are not present cause for alarm. Once the sea approaches are cut and ECA shipments halted, however, the isolated city will face economic strangulation if it does not first fall militarily. High ranking Shanghai leaders are said to expect that the Nationalists will abandon

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Shanghai in the near future. They envisage a "Dunkirk" evacuation from the south banks of the Yangtze, east of Woosung. The successful reenactment of Dunkirk seems unlikely for the Nationalists would first have to stabilize the situation west of the Whangpoo River, a remote possibility. Although subject to some modification from other than military factors, Communist occupation of Shanghai should occur by the end of the month, or shortly thereafter.

Meanwhile, according to censored news releases from Shanghai, the Communists are pushing south and southeast from the Chekiang-Kiangsi Railroad and have driven as far as Nigtu and Juichin (Communist capital in 1931) some 230 miles from Canton in southeast Kiangsi, and "encircled" Chienyang, in northwestern Fukien, 120 miles from Foochow.

From presently reported positions, Communist General LIU Po-cheng could launch a two-pronged drive southeast to the Fukien coast, and south into Kwangtung--joining forces with Communist guerrillas now holding broad stretches of rural Kwangtung--and thence to Canton, or veer southwest and west to menace the retreat of PAI Chung-hsi and cut him off from his political and economic base in Kwangsi. It is still too early to discern exactly where LIU's main effort will be directed, but present indications suggest Canton. LIU's exact whereabouts for past months have been something of a riddle; it has long been expected, by neutral observers and Communist propagandists alike, that LIU and his guerrilla forces would lead the eventual Communist push into South China. If LIU is on his way to Kwangtung, the emergence of any anti-Communist resistance in south China or unity of anti-Communist efforts elsewhere in China is severely threatened.

Nationalists debate flight from Canton--Frightened by the possibility of a Communist drive on Canton and confused by disastrous factionalism, Nationalist officials are discussing where to go next. Hitherto, right-wing leaders have given first consideration to Tawian, already prepared as a final Nationalist refuge. However, growing fear that such a move would bring withdrawal of recognition by foreign powers is causing reexamination of this course. Acting President LI's following, moreover, is more directly concerned with southwest China than with Taiwan. While LI's primary interest in Kwangsi might point to Kweilin as a possible future center of resistance, Chungking is likely to be first choice for various Nationalist leaders. Although the Nationalists might then attempt to exploit the analogy of the movement to Chungking during the Japanese War, actually such a move probably would hasten the downfall of Nationalist China.

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Meanwhile, Acting President LI reportedly is preparing for a showdown with CHIANG Kai-shek over implementation of the latter's assurances

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of non-interference with the Government. Although CHIANG sent a letter to Premier HO Ying-chin in answer to LI's request for actual control of governmental resources, nearly all the statements made therein were general and indicated CHIANG's refusal to yield actual power despite his present intention not to resume office. However, LI reportedly plans first to revamp the cabinet and then order shipment of the Government's gold reserves from Taiwan to Canton. Apparently aware that Taiwan's Governor, CHEN Cheng, is unlikely to comply with this instruction or yield his office to a new appointee (such as SUN Li-jen), LI has asked for US support in effecting CHEN's removal. Should LI carry on the struggle in this fashion, the Nationalist split may soon be irreparable.

LI's apparent intention to appoint YEN Hsi-shan or CHU Cheng to head a new cabinet further evidences the low level of Nationalist political fortunes. YEN is the refugee ex-warlord of Shansi, with a long record of antagonism to the National Government and little present influence except possibly with certain Kwangtung generals. CHU Cheng is a colorless Kuomintang elder, long President of the Judicial Yuan. Despite HO Ying-chin's continuation in the Defense Ministry and the probable appointment of PAI Chung-hsi as Chief of Staff, the new cabinet, if organized, will be even less effective than is the present one.

Moderate economic policy in Peiping--Communist sincerity regarding the "shift to the cities" reconstruction program, announced for North China in March, 1949, is now fairly evident as a result of Party actions and directives during April. On 23 April, the Peiping Municipal Committee of the Chinese Communist Party (CCP) held a meeting with "factory managers, company managers, military representatives and labor union directors," in which the new economic program was endorsed, application of the policy was discussed and party workers were warned in strong language against any deviation from the program by "mistake or prejudice." PENG Chen, Secretary of the Municipal Committee, promised that the government would protect privately-owned industries and improve marketing conditions. PENG also stated that industry would be "directed" by the principle of "lighter taxes for industries than commerce, for heavy industry than light, and for manufacturers of daily necessities than for makers of luxury goods." He concluded by assuring the meeting that, according to Chairman MAO's directive, the CCP must "allow profit for both capital and labor and maintain good relations....with foreign countries."

"C"

The action of the Communist Ministry of Industry and Commerce regarding the Kailan Mining Administration (KMA) is a further significant indication that CCP political prejudices are subordinate to economic objectives at present. To insure profitable operations for the part-British firm, the CCP promised decreased taxes, more transportation, pit props from Manchuria

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and a disciplined labor force. This attitude appears to be a direct result of the March policy, since the Communist radio proudly broadcast that this was a "typical solution" of industrial problems in North China, and completely in accord with MAO's principles.

BURMA

Commonwealth aid problems--The British Embassy in Rangoon has stated that the nature of the Commonwealth aid promised to Burma is still undecided, but indicated that it would be mainly arms and military equipment. No long-term financing is contemplated, although a small increase in currency issue is still being considered. Meanwhile, the Burmese have been led to believe that Commonwealth assistance will be immediate and unqualified and are apparently planning to use the new arms to step up action against the Karens, contrary to the Commonwealth desire for a negotiated Burman-Karen agreement followed by a major effort against the Communists.

"B"

In view of this attitude, any Commonwealth effort to impose conditions offers difficulties and the Commonwealth appears to be taking a calculated risk. If the Commonwealth reneges on its promise, an unfavorable Burmese reaction is certain. If it attempts to impose conditions, on the other hand, bitter Burmese resentment can be expected, especially among the military leaders. Yet unconditional arms supply to the Burmese is likely to result in actions inconsistent with Commonwealth wishes and, worse, much of the matériel might be turned against the Government either through desertion of Government troops or insurgent raids. One alternative which offers some slight hope of success, however, appears to be action by the Commonwealth Ambassadors in Rangoon (who constitute the medium through which the aid program is to be implemented) to bring judicious pressure upon the Burmese Government to come to terms with the Karens by giving only token assistance until the Burmans become more amenable.

Meanwhile, unsettled conditions, coupled with the obvious weakness of the Burmese Government, appear to be encouraging separatism among the Shan and Kachin minorities who inhabit a large part of the north and north-east. Leaders of these people recently met in Bahmo to consider measures for self-protection during the continued disorders. These leaders have always been suspicious of Burmese intentions towards them and are unenthusiastic about their status in the Union of Burma. They are not only concerned about their future security, but probably also believe that they have contributed far more to the Burmese Government than they have received in return. The Kachin leaders who attended the meeting are reported to have agreed to recruit two battalions for self-defense, while the Shan chieftains agreed to strengthen their private armies. There is no indication that these

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forces would be incorporated into the Burmese Army, as proposed by Prime Minister Thakin Nu and the Minister for Kachin Affairs in Rangoon.

Regional recruiting of this sort would be a severe blow to the Burmese Government's present plans to raise 10 battalions of frontier peoples. Furthermore, while it seems unlikely that the Shans and Kachins will formally secede from the Union, they will probably continue efforts to increase their autonomy at the expense of the Burmese Government and further disassociate themselves from the disturbances in central and southern Burma.

INDONESIA

Progress in Batavia talks--Although obstacles stand in the way of executing the terms of the recent preliminary Dutch-Republican agreement, the outlook in Batavia for settlement of the basic issues covering Republican restoration and a cease-fire order is good. Committee "One", charged with the problem of returning the Republican administration to the Jogjakarta Residency, has made considerable progress. To date the major problem of Committee "One" has been to schedule the evacuation of some 40,000 civilians from the area. However, a statement by the Sultan of Jogjakarta, guaranteeing personal and material safety for all individuals irrespective of nationality, is expected to reduce the number of prospective evacuees sharply. Actual evacuation may begin as early as 23 May. Committee "Two", charged with the restoration of "peace and order", has made less progress. Dutch and Republicans both are anxious to accelerate the work of this body and a TNI (Republican Army) officer has been assigned as an advisor in order to strengthen the Republican position. "8"

Both parties are reported to be cooperating unusually well in carrying out terms of the agreement. The majority of Dutch departments in Batavia, contrary to expectations, are giving a strong measure of support to Van Roijen, the Netherlands delegate. Dutch-controlled public information organs, however, have been publishing statements which are likely to result in misunderstandings between the delegations. Van Roijen intends to correct this situation and believes that if the expected progress on implementation of the preliminary agreement can be continued during May and June, the conference at The Hague on a formal agreement may be held in July.

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